2022 Consumer Practice Extravaganza

How to Bring a § 523(a)(8) Claim

R. Caleb Chaplain
U.S. Bankruptcy Court (W.D. Va.); Harrisonburg

Hon. Cecelia G. Morris
U.S. Bankruptcy Court (S.D.N.Y.); Poughkeepsie

Stanley Tate
Tate Law; St. Louis, Mo.

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The Honorable Cecelia G. Morris

Judge, U.S. Bankruptcy Court (S.D.N.Y.); Poughkeepsie, NY

Caleb Chaplain

Career Law Clerk, U.S. Bankruptcy Court (W.D. Va.); Harrisonburg, VA

Stanley Tate

Tate Law; St. Louis, MO

Introduction: Tests to Determine Dischargeability of Student Loans

Brunner Test: Prong 1

"that the debtor cannot maintain, based on current income and expenses, a 'minimal' standard of living for [himself] if forced to repay the loans"

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Repayment Plans

Brunner Test: Prong 1

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Brunner Test: Prong 2

"that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period for student loans"

Brunner Test: Prong 2

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What is the "Repayment Period"?

Brunner Test: Prong 2

"that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period for student loans"

What is a "Significant Portion"?

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"that the debtor has made good faith efforts to repay the loans"

Brunner Test: Prong 3

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Repayment Plans

Brunner Test: Prong 3

"that the debtor has made good faith efforts to repay the loans"

Prior Payments by the Debtor

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The Honorable Cecelia G. Morris
Judge, U.S. Bankruptcy Court (S.D.N.Y.); Poughkeepsie, NY

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Career Law Clerk, U.S. Bankruptcy Court (W.D. Va.); Harrisonburg, VA

Stanley Tate
Tate Law; St. Louis, MO

Materials Outline:[1]

[1] Portions of these materials are adapted from materials prepared for the Fourth/D.C. Circuits Breakout Session at the 96th Annual National Conference of Bankruptcy Judges.

I. Basics of Filing a Complaint to Determine Dischargeabilty of Student Loan Debt

Section 523(a)(8). In general, a discharge under the Bankruptcy Code does not discharge an individual from student loan debt "unless excepting such debt from discharge would impose an undue hardship on the debtor." 11 U.S.C. § 523(a)(8).

While section 523(a)(8) is limited to discharge under section 727, 1141, 1192, 1228(a), 1228(b), and the chapter 13 hardship discharge under section 1328(b), the "super discharge" of section 1328(a) likewise excepts debts "of the kind specified in" 523(a)(8). 11 U.S.C. § 1328(a)(2).

Jurisdiction. Bankruptcy courts may head and determine "core proceedings." 28 U.S.C. § 157(b)(1). "[D]eterminations as to the dischargeability of particular debts" are core proceedings. *Id.* § 157(b)(2)(I).

Filing a Complaint. To seek a determination of dischargeability of student loan debt from the bankruptcy court, a party must file a complaint with the bankruptcy court initiating an adversary proceeding. *See* Fed. R. Bankr. P. 7001(6) (including in the list of adversary proceedings "a proceeding to determine the dischargeability of a debt"); Fed. R. Bankr. P. 4007(e) ("A proceeding commenced by a complaint filed under this rule is governed by Part VII of these rules.").

In the alternative, if the dischargeability determination has not been made by the bankruptcy court, a party may seek a determination from the state court or other nonbankruptcy court. *See, e.g.*, *In re Crawford*, 183 B.R. 103, 105 (Bankr. W.D. Va. 1995) ("Bankruptcy courts and state courts share concurrent jurisdiction over several of the exceptions to discharge enumerated in 11 U.S.C. § 523(a).").

Who May Initiate the Nondischargeability Action? Both creditors and debtors may file the complaint to determine dischargeability of the student loan debt. *See* Fed. R. Bankr. P. 4007(a) ("A debtor or any creditor may file a complaint to obtain a determination of the dischargeability of any debt.").

Timing. Complaints to determine dischargeability of student loans dischargeability under section 523(a)(8) "may be filed at ant time." *See* Fed. R. Bankr. P. 4007(b).

"A case may be reopened without payment of an additional filing fee for the purpose of filing a complaint to obtain a determination" of whether student loans were discharged. *See id.*

Burden. While the creditor typically must carry burden to have its debt excepted from discharge, the debtor has the burden under section 523(a)(8) to show that the student loan debt is not excepted from discharge. While the student loan creditor may need to prove that the student loan debt is of the type governed by section 523(a)(8), the ultimate burden is on the debtor to show that "excepting such debt from discharge would impose an undue hardship on the debtor."

II. Tests for Determining Dischargeability of Student Loans

"In attempting to apply the undue hardship language, courts have strayed from a natural reading of the statute to develop judicial tests." *Bell v. U.S. Dep't of Educ. (In re Bell)*, 633 B.R. 164, 171 (Bankr. W.D. Va. 2021). Two primary judicially developed test have emerged. While a majority of the circuits which have adopted a test utilize the three-pronged *Brunner* test, a minority of courts employ a totality of the circumstances inquiry.

The Totality of the Circumstances Test

The United States Court of Appeals for the Eighth Circuit and the Bankruptcy Appellate Panel for the First Circuit have adopted a the "totality of the circumstances" test. *See Long v. Educ. Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549, 553 (8th Cir. 2003); *Bronsdon v. Educ.*

Credit Mgmt. Corp. (In re Bronsdon), 435 B.R. 791, 800 (B.A.P. 1st Cir. 2010). The totality of the circumstances test requires a debtor to prove by a preponderance of evidence that:

> (1) his past, present, and reasonably reliable future financial resources; (2) his and his dependents' reasonably necessary living expenses; and (3) other relevant facts or circumstances unique to the case, prevent him from paying the student loans in question while still maintaining a minimal standard of living, even when aided by a discharge of other prepetition debts.

Bronsdon, 435 B.R. at 798; *see also Long*, 322 F.3d at 554.

The Brunner *Test*

The issue in *Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987), was whether a debtor who sought to discharge student loans immediately after obtaining a graduate degree had shown that repayment of those loans was an undue hardship. The bankruptcy court discharged those loans. The district court reversed crafting a three-part test adopted by the Second Circuit.

The three-prong test, crafted by the district court to prove undue hardship, requires a showing that (1) the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) the debtor has made good faith efforts to repay the loans. *Brunner*, 831 F.2d at 396.

Of note, *Brunner* was considering the language of section 523(a)(8) as it was enacted in 1978 (and amended in 1979) when student loans were discharged after 5 years unless repayment (before 5 years) was an undue hardship.

III. Evolution of 11 U.S.C. § 523(a)(8)—When Did It Become So Complicated?

The enactment of Title 11 of the United States Code in 1978 provided the first iteration of section 523(a)(8)'s exception to discharge for certain student loan debt:

> (a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt— . . .
> (8) to a governmental unit, or a nonprofit institution of higher education, for an educational loan, unless—,
> (A) such loan first became due before five years before the date of the filing of the petition; or
> (B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents; . . . .

Pub. L. No. 95-598, § 101, 92 Stat. 2549, 2591 (1978). This enactment limited the exception to debts for educational loans owed to a government unit or a nonprofit institution of higher education.

As originally enacted, section 523(a)(8) contained two bases for a discharge exception of certain student loan debt. First, if the first payment on the educational loan had become due more than five years prior to the debtor's bankruptcy filing, the debt was dischargeable. Second, if excepting the debt from discharge would impose an undue hardship on the debtor and the debtor's dependents, the debt was dischargeable. Based on the legislative history, these provisions were "designed to remedy abuses of the educational loan system by restricting the ability of a student to discharge an educational loan by filing for bankruptcy shortly after graduation, and to safeguard the financial integrity of educational loan programs." *Santa Fe Med. Servs. v. Segal (In re Segal)*, 57 F.3d 342, 348 (3d Cir. 1995).

In 1979, Congress amended section 523(a)(8) to strike out "to a governmental unit, or a nonprofit institution of higher education, for an educational loan" in the umbrella of section 523(a)(8) and replaced the language with "for an educational loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or a nonprofit institution of higher education." Pub. L. No. 96-56, § 3, 93 Stat. 387, 387

(1979). This expanded the breadth of the types of student loan debt within the discharge exception and clarified that section 523(a)(8)(A)'s five-year prepetition period calculation was "exclusive of any applicable suspension of the repayment period." *Id.*

The Crime Control Act of 1990 made two significant amendments to section 523(a)(8). First, Congress again expanded the scope of the types of debt included in the section 523(a)(8) exception. Second, the Crime Control Act enlarged the five-year period in section 523(a)(8)(A) to a seven-year period and expanded the type of debt from "loan made" to reflect the debts newly inserted into the general coverage of section 523(a)(8).

In 1998, Congress deleted subsection (A) of 523(a)(8). Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971(a), 112 Stat. 1581, 1837 (1998). This left only one basis for debtors to have their student loans determined dischargeable: proving an "undue hardship."

The most recent amendments to section 523(a)(8) occurred in 2005. The amendments restructured the language, striking the then-existing (a)(8) in its entirety and added the following:

> (8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—
>
> (A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or
>
> (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or
>
> (B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59 (2005) ("BAPCPA"). In addition to reordering the language, the amendments again expanded the types student loans subject to the discharge exception beyond those insured or guaranteed by a governmental unit or made under any program funded in whole or in part by a

governmental unit or nonprofit institution. Throughout the evolution of section 523(a)(8), the phrase "undue hardship" has remained.

As part of BAPCPA, Congress added a "presumption of undue hardship" in section 524(m)(1) of the Code. Although rebuttable, the "presumption of undue hardship" in section 524(m)(1) provides a comparison of income less expenses to the monthly payments to be made on a debt to be reaffirmed. If the debtor's income less expenses leaves insufficient income to make payments on the debt to be reaffirmed, the statute provides that the presumption of undue hardship arises. On the other hand, if making scheduled payments on the subject debt is within the debtor's budget, no presumption of undue hardship arises.

Although Congress uses the phrase "undue hardship" in the current Bankruptcy Code once in section 523 and eight times in section 524, Congress did not define the phrase. *See* 11 U.S.C. §§ 101, 523(a)(8), 524(c)(3)(B), (c)(6)(A)(i), (k)(3)(J)(i), (k)(5)(A)–(B), (k)(6)(A), (m)(1).

IV. Similar Facts – Different Outcomes: A Fourth Circuit Three-Case Comparison

Background: The Fourth Circuit Adopted the Brunner Test (or Did It?)

The Fourth Circuit adopted the *Brunner* test in analyzing "undue hardship." *Educ. Credit Mgmt. Corp. v. Frushour (In re Frushour)*, 433 F.3d 393, 400 (4th Cir. 2005); *Spence v. Educ. Credit Mgmt. Corp. (In re Spence)*, 541 F.3d 538, 542 (4th Cir. 2008). The Fourth Circuit's opinions applying "undue hardship" in section 523(a)(8) were issued after the BAPCPA amendments, but each opinion was on appeal from decisions entered by the bankruptcy courts in cases filed prior to the enactment of BAPCPA.

In adopting the *Brunner* test, the Fourth Circuit found that "the *Brunner* test best incorporates the congressional mandate to allow discharge of student loans only in limited circumstances." *See Frushour*, 433 F.3d at 400.

The second prong of the *Brunner* test requires a court to consider current circumstances, the likelihood that those circumstances will remain or persist, and whether those circumstances are likely to persist during a significant period of the remaining term of the loan. The Fourth Circuit describes this prong as "a demanding requirement" requiring that "a 'certainty of hopelessness' exists that the debtor will not be able to repay the student loans." *See id.* at 401. Indeed, the Fourth Circuit concluded the debtor had not shown the likelihood her present circumstances "will extend for the rest of her repayment period *or that she will not be able to pay off her loans at some future date*." *Frushour*, 433 F.3d at 402 (emphasis added).

The Second Circuit describes the prong as whether it is "likely" (query whether this means "certain") the circumstances will "persist for a significant portion of the repayment period of the student loans" *Brunner*, 831 F.2d at 398. Does the *Brunner* test as articulated by the Second Circuit square with its articulation by the Fourth?

Three Recent Student Loan Decisions from Courts within the Fourth Circuit

Outcome #1: No Discharge

Opinion: *Hock v. U.S. Dep't of Educ. (In re Hock)*, Adv. P. No. 19-03016, 2021 WL 1042870 (Bankr. W.D.N.C. Mar. 17, 2021).

Debtor's Age: 70

Student loan balance when bankruptcy filed: $143,581.48, of which $118,105.46 was principal and $25,475.84 is accrued interest

Prong One: whether the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans.

Debtor was not employed, had serious health condition impeding her ability to work, and was a care provider for her permanently disabled husband.

The bankruptcy court determined the phrase "current income" under the first prong of the *Brunner* test does not refer to the statutory defined term of "current monthly income." The bankruptcy court considered actual household income (including her and her non-filing spouse's social security benefits plus the spouse's VA disability and pension) compared to reasonable household expenses.

The bankruptcy court determined the debtor's household income was sufficient to pay her loan payments while maintaining a minimal standard of living. So, she failed prong one.

Prong Two: what additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans.

Debtor was unemployed, had medical conditions, and was a care provider for her permanently disabled husband. Yet, the debtor had household income from her and her spouse's social security, the spouse's VA disability, and the spouse's pension sufficient to pay the monthly loan payment. Because of the nature of the income, the debtor's household income is likely to continue. A such, she failed prong two.

Prong Three: whether the debtor has made good faith efforts to repay the loans

The bankruptcy court concluded the debtor did not make a good faith effort to repay the loans because (1) the debtor obtained deferments and only made two payments during the life of the loans; (2) failed to pursue loan consolidation or income-based repayment options; (3) failed to apply for an administrative disability discharge prior to seeking the bankruptcy discharge; and (4) failed to minimize her expenses. For these reasons, the debtor failed prong three.

Outcome #2: Partial Discharge

Opinion: *Randall v. Navient Sols. (In re Randall)*, 628 B.R. 772 (Bankr. D. Md. 2021).

Debtor's Age: 68

Student loan balance when bankruptcy filed: approximately $190,000

Prong One: whether the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans.

The debtor had employment income for her regular hours and overtime. She demonstrated that her expenses are reasonable and necessary. The evidence showed that if the debtor moved she may have lower housing expenses but would be living in a crime prone area. The bankruptcy court considered the suggestion that the debtor move to a smaller apartment with lower rent but "was not willing to require a debtor to move into unsafe or substandard living conditions just to repay a student loan debt." The bankruptcy court concluded the debtor could not maintain a minimal standard of living if forced to repay all of her student loan debt. So, the debtor satisfied the first prong.

Prong Two: what additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans.

The bankruptcy court determined that the debtor's age limits her ability to continue to maintain the overtime hours, and, coupled with her limited earning capacity, concluded the debtor's situation is unlikely to improve or even stay the same for the foreseeable future.

Prong Three: whether the debtor has made good faith efforts to repay the loans

The bankruptcy court found that the debtor made some payments on the student loans, did not ignore the student loan debts, and appeared to have managed her financial affairs to the best of her ability. Although she did not seek loan consolidation, the bankruptcy court concluded on balance that she had demonstrated "good faith attempts to repay or otherwise address her student loan debt."

The bankruptcy court concluded the record supported a finding of undue hardship if the debtor was required to repay the student loans in full. The court then noted that the debtor had the ability to repay a portion of the student loan debt. The court ordered $12,000 of the total student loan debt excepted from discharge and granted a discharge of the remaining student loan debt.

Outcome #3: Full Discharge

Bell v. U.S. Dep't of Educ. (In re Bell), 633 B.R. 164 (Bankr. W.D. Va. 2021).

Debtor's Age: 67

Student Loan Balance when bankruptcy filed: $109,983.88, of which $24,710.41 is current interest and $10,892.47 is capitalized interest.

Prong One: whether the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans.

After filing bankruptcy in late 2019, the debtor's income dropped dramatically (in part due to the COVID 19 pandemic). The debtor made efforts to reduce discretionary expenses yet even with such adjustments, his necessary expenses exceeded his income. The bankruptcy court concluded he could not maintain a minimal standard of living based on his current income and expenses if forced to repay the loan.

Prong Two: what additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans.

The bankruptcy court considered the debtor's education, employment history, employment income, current income, efforts to find higher paying jobs, and lack of professional licenses and found that the debtor's current financial circumstances are not likely to improve enough to permit him to make loan payments on the debt, much less repay the debt.

The bankruptcy court was not persuaded that availability of an "income-based repayment plan" calls for a finding that the debtor does not satisfy prong two. The court observed "[i]t is hard to imagine a debtor who would qualify for a discharge under section 523(a)(8) but who would not also qualify for an income-based repayment plan at zero dollars per month. If this Court were to accept the DOE's argument on this point, section 523(a)(8) would be rendered essentially meaningless—the DOE could prevail in any case involving section 523(a)(8) by simply offering the debtor an alternative repayment plan."

The court concluded the debtor met prong two.

Prong Three: whether the debtor has made good faith efforts to repay the loans

Although the debtor made no payments on the loan, the bankruptcy court noted that he made no payments on the loans because his financial situation rendered him unable to do so. The debtor's efforts to secure employment, continued communication with the DOE with respect to his loans, and his successful requests for forbearances and alternative repayment programs indicate good faith efforts to repay the loans. Rather than completely ignoring the loans, the debtor remained on top of the administration of his student loans for the entirety of their existence and only requested a discharge of the student loans when his insolvency forced him to file bankruptcy.

The student loans were discharged.

Faculty

R. Caleb Chaplain is a career law clerk to Hon. Rebecca B. Connelly of the U.S. Bankruptcy Court for the Western District of Virginia in Harrisonburg and is an adjunct professor of bankruptcy law at Washington and Lee University School of Law. Prior to career clerking, he was a term law clerk for both Judge Connelly and Hon. Paul M. Black, Chief Judge for the U.S. Bankruptcy Court for the Western District of Virginia. Mr. Chaplain is a coordinating editor for the *ABI Journal* and has authored articles. He also is a 2022 honoree of ABI's "40 Under 40" program. Mr. Chaplain volunteers as a member and current president of the board of directors of Second Home Learning Center, a nonprofit that provides out of school care, education and development opportunities for children in low-income households in Harrisonburg. He received his B.A. from Dartmouth College and his J.D. from Indiana University Maurer School of Law.

Hon. Cecelia G. Morris is a U.S. Bankruptcy Judge for the Southern District of New York in Poughkeepsie, appointed on July 1, 2000. She also served a term as Chief Judge, starting on March 1, 2012. Prior to her appointment to the bench, Judge Morris clerked for the U.S. Bankruptcy Court for the Southern District of New York starting in December 1988. Prior to that, she clerked for the U.S. Bankruptcy Court for the Middle District of Georgia from February 1986 until she moved to New York. Before her career with the court, Judge Morris had a private law practice in Macon, Ga., from May 1981 until February 1986. She served as an Assistant District Attorney and as the administrator of the Civil Division Child Support Recovery Unit, Griffin Judicial Circuit in Griffin, Ga., from September 1979 until May 1981. She also had a private law practice in Griffin from October 1977 until January 1978 and clerked at Seay Sims & Park (now Bolton & Park) in Griffin in 1976. Judge Morris has participated as a trainer in many mediation/arbitration programs sponsored by the Federal Judicial Center, the Association of the Bar of the City of New York, the National Association of Security Dealer Regulation and Bankruptcy Court, Endispute Inc. and the Center for Public Resources, Inc. She has successfully mediated many disputes in some of the most prominent cases pending before the U.S. Bankruptcy Court for the Southern District of New York. Judge Morris is an active participant in many bar outreach programs and has been honored to be the keynote speaker at several events, including the Federal Judicial Center's Clerk of Court and Chief Deputies Conference and Weil Gotshal and Manges' Women@Weil program. She has served as an editor of a treatise on bankruptcy being developed by Bloomberg Law, and she published an article describing the history and legal basis of the court's loss-mitigation program in the Spring 2011 edition of the *ABI Law Review*. She has also authored several articles on electronic filing, including a chapter on electronic case filing in *Collier on Bankruptcy*, and has published articles on loss-mitigation, mediation, the consumer credit counseling requirement in bankruptcy and cross-border insolvency cases under chapter 15 of the Bankruptcy Code. Judge Morris has testified before Congress and served on the Bankruptcy Judges Advisory Board to the Administrative Office of the U.S. Courts. She also has taught bankruptcy ethics at St. John's University's LL.M. in Bankruptcy program and served as a member of the Barry Zaretsky Roundtable Steering Committee at Brooklyn Law School, on the advisory board of the *ABI Law Review*, and as a member of the International Insolvency Institute, American College of Bankruptcy, National Conference of Bankruptcy Judges and the Global Restructuring Organization's Scientific Committee, headquartered in Modena, Italy. Judge Morris received the Annual Conrad B. Duberstein Memorial Award for Excellence and Compassion in the

Bankruptcy Judiciary and the *New York Law Journal* Impact Award for pioneering the use of e-filing in federal court. She received her B.S. from West Texas State University and her J.D. from the John Marshall Law School.

Stanley Tate is a sole practitioner with Tate Esq. LLC in St. Louis, Mo., and focuses on student loan law. His law firm offers a variety of student loan debt solutions, from eliminating defaults, negotiating settlements, defending lawsuits, lowering monthly payments to pursuing discharges in bankruptcy. Previously, Mr. Tate was a paralegal with the U.S. Army. He received his B.S. in management in 2004 from Southern Illinois University, Carbondale and his J.D. in 2013 from Texas Southern University Thurgood Marshall School of Law.